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SUBJECT: FROM A TRICKLE TO A FLOOD: CHINA'S AGRICULTURAL SUBSIDIES
MULTIPLY

Refs: A. FBIS/OSC #CPP20081019045001

(U) This cable is Sensitive But Unclassified. Please protect accordingly.

¶1. (SBU) Production and input subsidies have multiplied rapidly and the value of support has risen exponentially since the watershed moment in 2006 when China eliminated its centuries-old agricultural tax. Agricultural subsidies now play an increasingly important role in guiding production decisions, and when combined with China's food security policy, subsidies determine competitiveness of crops within China and impact trade patterns. Though subsidies will likely remain within China's international obligations, current trends suggest that subsidies will soon reach the limits of WTO agricultural subsidy commitments. END SUMMARY AND COMMENT.

ROLE OF AGRICULTURAL SUBSIDIES EXPANDS

¶2. (SBU) In recent years, China has made the significant transition from taxing the rural sector to subsidizing it. 2006 marked a watershed as China's centuries-old agricultural tax was removed and the structure of rural taxation and payment for local services and infrastructure dramatically shifted. Despite allowing farmers to keep more of their income, the central government feels compelled to do more to increase assistance to local governments for the loss of the tax, speed modernization and farm productivity increases, and close the rural-urban income gap by supplementing rural incomes with direct and indirect subsidies. China's key public policy documents (e.g., The Decision of the Third Plenary Session of the 17th Central Committee of the Communist Party of China in October 2008, Ref A) confirm the rapid growth of input subsidies, direct payments, price controls, and subsidized loans. Recent analysis shows that the largest subsidies are currently being given to the grain, pork, and dairy sectors, but that additional programs and recipient groups are being added yearly.

¶3. (SBU). Despite some Chinese government declarations about the size of Chinese subsidies, USDA research suggests that the actual scope and scale has not been included in the current official estimate. A recent USDA Foreign Agricultural Service (FAS) report compiled available information on the scope of China's agricultural subsidies from 2005-2008 based primarily on FAS Global Agricultural Information Network (GAIN) reports on the primary agricultural commodities produced in China. Additional information is taken from the USDA Economic Research Service (ERS), Chinese official press releases, and local press. The full report, including data and tables, and all other GAIN reports mentioned in this cable can be

found at www.fas.usda.gov or www.usdachina.cn as CH9028.

OVERVIEW OF CHINA'S DOMESTIC SUPPORT

14. (SBU) For the past 60 years, China has pushed strong economic growth through industrialization and developing urban areas. As the income gap between urban and rural populations widened, policy makers began looking "backwards" to address rural development and resolve social issues that are considered potentially disruptive to stability. The initial step towards improving rural farmers' lifestyles was to increase farm incomes by removing the centuries-old agricultural tax, which was removed completely in 2006. At the same time that the agriculture tax was phased out, subsidies aimed at supplementing agricultural incomes began, including those for input subsidies, direct payment, loan subsidies, and price supports.

15. (SBU) On March 5, 2009 at the 11th National People's Conference, Premier Wen Jiabao addressed the government financial contribution to the sector by announcing that agriculture spending during 2008 totaled US \$87.3 billion (RMB 596 billion), an increase of 38 percent from the previous year. He noted that the spending including US \$15.1 billion (RMB 103 billion) used for direct subsidies, inputs, machinery, and improved crop varieties. In 2009, these categories of subsidies are slated to increase to \$18 billion (RMB 123 billion).

SOMETHING FOR EVERYBODY

16. (SBU). In January 2009, the Chinese Central Committee of the
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Communist Party issued 2009 Document No. 1 (GAIN CH9026), its annual summary of efforts planned to address the range of rural issues in the upcoming year. This document is instructive in describing the basic objectives of the subsidies and the structures the Chinese Government intends to pursue. Generally speaking, the priorities are 1) income support and 2) increased production.

17. (SBU) According to Document No. 1, the following specific goals are prominent on the list of activities China is encouraging:

- Food Security - in particular grains
- Farmer income support
- Consolidation - especially livestock and agricultural processing sectors
- Increased Productivity - in all sectors through the use of innovation, technology, more inputs, and mechanization
- Creation of national champion enterprises
- Increasing rural financial services
- Rationalization and Conservation - encouraging concentration of certain industries in areas that have geographic or other comparative advantages and optimizing/conserving use of water and land resources

18. (SBU). Additionally, Document No. 1 lists the following as the preferred subsidy formats:

- Price Supports
- Subsidized Credit
- Direct Payments
- Preferential Tax Schemes

LIVESTOCK AND GRAIN THE BIG WINNERS

19. (SBU) China's subsidy policy can also be seen as a clear extension of a top national priority: food security. As such, a clear majority of China's current subsidies go to grains and animal protein. The grains sector receives about 95 percent (94 million RMB of the 103 million RMB) of the direct support reported by the government in 2008, with most of remainder going to the pork and dairy sector. In 2009, the scope of the subsidies increased and the percentage going to non-grains sectors increased.

110. (SBU) As of 2009, the types of commodities/sectors that have

been identified for subsidies are: grains, oilseeds, biofuels, dairy, pork, tomatoes, walnuts, canned fruit, asparagus, citrus, hides and skins, and cotton. Many of these sectors compete with U.S. products in third countries, are exported to the United States, or compete with U.S. products imported into China. In addition, China has also significantly increased non-product specific support that does not directly affect production decisions, programs that would generally fall in the WTO green box category.

¶11. (SBU) However, the hidden story is that there are many subsidies not contained in the government figures. Two of the programs identified as providing the most benefit to the agricultural industry are the elimination of the corporate income tax (GAIN CH8078), the exemptions provided to agriculture under China's value-added tax (GAIN CH7018), periodic programs to subsidize exports (ERS Report Source WRS-01-02) and other programs.

SUBSIDY RESEARCH LIMITATIONS

¶12. (SBU) Overviews of Chinese agricultural policies are an important source of information on the evolution of Chinese policy, with FAS commodity reports and ERS reports, such as the April 2009 "China's Ongoing Agricultural Modernization: Challenges Remain After 30 Years of Reform", playing a key role in English language research. However, there have been very few comprehensive, current studies on Chinese subsidy policies because their history is fairly recent and their impact is only beginning to be felt.

¶13. (SBU) Researchers face several hurdles in this area and make any analysis of the scope and breadth of Chinese agricultural subsidies difficult. The following issues should be taken into account by readers of subsidy research and be considered caveats relating to the fullness and accuracy of the data in the April 2009 FAS report. While all the programs listed in the FAS report are confirmed through government sources or government released information, the following issues are the most common reasons why certain information is not available or could not be confirmed:

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- Transparency: Most Chinese subsidy program details are not public information. While the program itself may be announced publically, implementing regulations are rarely public. The type of information absent often includes the value of the program, participant eligibility, number of participants, or how the subsidy is distributed.
- Uniformity of Eligibility: Unlike many countries, most Chinese subsidies do not have universal eligibility. There are simply too many farmers. Unpublished criteria or eligibility differences between provinces make it difficult to ascertain the total number of participants or other fixed data points (Ha/animals/kg) to use in calculating the total subsidy amount.
- Block Grants: Many subsidies are distributed to provinces for administration. The province is responsible for developing eligibility and distribution criteria. Depending on the program, it may be implemented in a different way in each province or even county.
- Sub-national Subsidies: This information is almost totally absent save local press releases and on-farm intelligence.
- Loan/Insurance Programs Opaque: Subsidized loans or insurance subsidies are particularly difficult to analyze due to the use unpublished loan rates or insurance premiums.

OTHER ONGOING RESEARCH

¶14. (SBU) As more attention is paid to this topic, research is expanding beyond the long-term work being done by USDA's FAS and ERS (ERS Report "China's New Farm Subsidies" - WRS-05-01). Recent work by an International Food Policy Research Institute (IFPRI) "Shadow Notifications" project has resulted in the publication of a third party attempt to create a likely China WTO submission. University academics that specialize in international agriculture, China, and WTO issues are also starting to follow China's subsidization policy more closely.

¶15. (SBU) U.S. industry is also becoming an active observer and critic of Chinese subsidy policy. For example, the U.S. pork industry has stated that it believes that China's pork policies already provide support at or above WTO obligations. Questions on pork subsidies have been asked by the United States in formal WTO submissions, without receiving a substantive Chinese reply. The U.S. pork, dairy, and wheat industries have all commissioned reports about various parts of the Chinese subsidy and VAT programs that they suspect do not conform to China's commitments. Since U.S. agricultural subsidy policy has long faced close observation, criticism, anti-dumping and safeguard cases, and WTO complaints, industry feels that close observance of WTO commitments is critical and has the same view for third countries.

MUM'S THE WORD

¶16. (SBU) Though discussion of China's subsidies is beginning to heat up among researchers, third country governments, and industry, China has never formally addressed the issue at the WTO. While China addresses some of its agriculture reporting commitments well, such as tariff rate quota administration, its adherence to others is spotty. In the case of agricultural subsidies, China has never submitted anything about its subsidies to the WTO since it became a member. While the growth of subsidies is clear to all observers, both domestic and foreign, few Chinese experts or officials seem to have a handle on the scope of the growth in subsidies. [Note: Some Ministry of Agriculture and Ministry of Commerce contacts are very curious about and can discuss subsidy policies of the United States and other countries, but they are reluctant or unable to grasp the scope of what is going on within China. Several MOA contacts asked for copies of the April 2009 FAS report so they could read it. End Note.]

TRADE IMPACTS UNCLEAR, BUT CONCERN GROWING

¶17. (SBU) The trade impacts of Chinese subsidies are far from clear. Given that most subsidies are relatively new, it is unlikely that subsidies have as much impact on U.S. trade as current SPS or TBT barriers. Nonetheless, industry is very concerned about the trends in this area. The U.S. industry has three inter-linked concerns: specialization, displacement of U.S. exports to Asia, and

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reduced access in China.

¶18. (SBU) The concern about specialization stems from information that China's provinces and localities focus resources in highly targeted international market segments. As in industrial areas, there are several well known examples where Chinese localities have seen profitable domestic or international markets and encouraged or provided targeted investment. Subsequently, Chinese producers monopolize a small segment in a short time and drive out foreign producers. An example of this fear is the Chinese domination of the global garlic market. Often, producers of U.S. horticultural crops or those that use significant manual labor are most concerned about the combination of cheap labor, targeted subsidies, and lax agro-chemical standards. U.S. apple and stone fruit producers have this concern.

¶19. (SBU) Similarly, industry is concerned that preferential policies and subsidies will be used to more aggressively export domestic surplus or by-products. Critics have long complained that the VAT refund rate is frequently used in China for domestic supply and price management. As some Chinese researchers have suggested, industry is concerned that China will ignore its commitments to the WTO in pursuit of domestic food security. Many in China argue that the zero subsidy commitment itself was a very bad deal and that it is not fair in comparison to the bound subsidy limits of more established WTO members. The first to raise this alarm has been the U.S. pork industry. In the wake of a deficit year that saw record pork exports from the U.S. to China, record subsidies and programs designed to build China's pork production capacity went into place, dampening U.S. market opportunities.

¶20. (SBU) As the U.S./China trade relationship grows in importance, discussion of domestic support payments will likely take on greater significance to both sides. Since China's accession to the WTO, agricultural trade has exploded. U.S. exports of agricultural, fishery, and forestry products to China grew from \$2.2 billion in 2001 to \$13.2 billion in 2008. Chinese exports to the United States of these categories of products went from \$2.3 billion to \$8.5 billion. The level of exports for the United States and China in the 2006 stood at \$7.7 billion and \$7.1 billion, respectively. U.S. exports are primarily made up of bulk or semi-processed commodities, while China's exports are largely value-added processed products.

COMMENT

¶20. (SBU) China's political leadership has signaled that agricultural subsidies will only get bigger. It is important to increase monitoring of these subsidies to understand their domestic impact on food security, market access, and Chinese exports. Given the increased spending, China will soon come to a point where it will find its WTO agricultural subsidy commitments constraining. When this happens, an important discussion inside China will be whether subsidies need to move toward a greater proportion of green box policies or China seeks ways to change its commitments or derail further negotiations. This growing realization that its commitments constrain policy objectives may spark a true review of China's future use of agricultural subsidies.

HUNTSMAN